The Commission is also obliged to ensure that telephone rates are "just, reasonable, and affordable", and that telecommunications_carriers do not "...use services that are not competitive to subsidize services that are subject to competition."

4. *Are these goals and objectives reflected in the Commission's Notice of Proposed Rulemaking?* Yes, but only incidentally and by no means adequately. They are identified in introductory parts of the Notice, but are noticeably absent in the paragraph (number 24) in which the Commission sets forth the factors it believes a system of cost allocation must balance and to which the notice repeatedly refers subsequently in solicitation of respondents' comments, suggestions, and views. The factors noted in paragraph 24 of the Notice refer to simplicity, adaptability, uniform applicability and consistency with economic principles of cost-causation. Except for the latter, these factors relate to administrative matters that, while important, are secondary to the public's real stake in this proceeding and to the policy goals enunciated by Congress.

5. *Why is it important for the Commission clearly and fully to express its goals in this proceeding?* It is critical for several reasons. First, the Commission is undertaking to implement a new law with novel statutory language. Thus, its actions here will constrain the Commission's options in other dockets and serve as precedent for subsequent proceedings in which similar issues -- allocation of costs among services with differential degrees of competition -- are at stake. Second, without a clear and complete statement of its public interest objectives, there is no way to evaluate -- in principle or empirically -- the sufficiency of the rules it adopts. Clarity and completeness are required to assure that the Commission's rules are accountable in terms spelled out by the new Act. Third, and most importantly, the goals set out by Congress are sometimes in conflict and require the Commission to weigh carefully their relative importance and to assure that they are properly balanced. Only by clear expression of its goals, and their relative weights, can the Commission and the public be assured that

parties have an opportunity to proffer material analysis that is fully informed by decision criteria the Commission will actually use.

6. *How would you respond to the Commission's invitation to suggest additional goals and purposes to be considered in this proceeding?* For the reasons above, I would urge the Commission to be as concise, complete and explicit as possible. To assure that the purposes of the Act are reflected in the Commission's deliberations and decisions, to provide clear direction to parties submitting policy analyses and to assure that the Commission's final rules can be evaluated for consistency with the Commission's construction of the "public interest", it is advisable to include the following goals:

- Promoting development of competitive video alternatives;
- Encouraging investment in new technologies and infrastructure;
- Streamlining regulation;
- Providing consumers alternative information and entertainment services;
- Providing regulatory clarity and administrative simplicity; and,
- Guarding against subsidy of competitive services by monopoly network services.

Taken together and correctly administered, these goals reflect more or less fully Congressional purpose and constitute the elements of a "public interest" or "social welfare" function that can be optimized by the Commission's rules in this proceeding. These goals are not always mutually consistent and require the Commission to weigh them and balance them. In balancing goals, it is important for the Commission to make very explicit the trade-offs involved and the basis for its judgments.

7. *Why does the foregoing list exclude, notwithstanding its inclusion in the*

Commission's notice, the goal of "consistency with the economic principles of cost-causation" as a goal of this proceeding? There are two reasons. First, I regard use of "cost causation" to determine common cost allocation as a means of policy rather than as a policy objective. A survey of the Commissions' past ratemaking and costing rules and proceedings will confirm that cost causation as a determinant of "just and reasonable rates" is a) as frequently absent as it is in evidence and b) when present, cost causation is almost invariably treated as one among several cost allocation and ratemaking criteria. Second, and most importantly, cost causation -- as it pertains to construction and operation of telecommunications networks -- is for practical purposes, simply unverifiable. Assuming a single service is the "cause" of a particular investment decision and the reason for incurring a companion complex bundle of associated expenses is not defensible without reference to and analysis of more information than normally available to regulators. Any economic or engineering study that prospectively allocates common costs to services or users by their purported "cause" is purely speculative. All such "causal" allocations require information about future states of the business -- technology, markets, corporate objectives and opportunities -- that is not known or knowable by outside analysts.

8. *Could you elaborate, in the specific context of the issues in this proceeding, the basis for concluding that "causation" is not verifiable for cost allocation purposes?* The Notice seeks to determine how best to recover joint and common costs of multipurpose telephone networks from regulated and nonregulated services. Future network investment costs will be for the most part common to the full array of services provided, irrespective of their regulatory status. Thus, it is increasingly important for the Commission to recognize that in the current technological and market environment, there is no one-to-one causal relationship between network investment and expenses and the "demand" for a particular service or by a particular class of uses or users. Decisions to invest in telephone networks are the result of many forces, most of which

are not reducible to simple statements about unidirectional, unilateral, customer class causation. Investment is driven by the need a) to replace, b) to modernize, and/or c) to expand existing plant. These requirements "originate" in several places and with more than one class of use or user. Moreover, several alternative investment programs that meet these requirements are feasible. The result of these considerations is to render determination of cost causation a highly subjective undertaking and one more akin to philosophy than economics.

To illustrate, consider the "causes" of the migration of telephone networks from analog facilities, optimized for voice transmissions, to a multipurpose, digital plant capable of serving numerous future applications -- some foreseeable, some not. The transformation is driven not by the demand for any particular application, but by the general cost and services advantages in all applications of digital vis-a-vis analog technology and by a largely undifferentiated user demand for the advantages of digital networks. "Digitization" serves a variety of applications, some of which can be identified a priori as cost causers, but many of which remain to materialize.

The Commission will require unprecedented prescience to determine, even approximately, what percent of future telco investment and expenses incurred for the general purpose of, say, "creating a ubiquitous, full service digital network" is caused by, and should be allocated to, a specific subset of the potential applications of such a network. Making such allocations is not a matter of applied economics, but a matter of pure conjecture.

9. What about allocating common costs according to usage or in proportion to the share in which direct costs are incurred? All ex ante, regulatory assignments of common costs are essentially arbitrary. There is no economically relevant or public policy useful information in usage data, when costs are in fact independent of usage. If costs are not traffic sensitive, allocating them by relative use is to substitute a fiction for fact. More importantly, allocating costs by relative use when they do not vary according to use is to assure a misallocation of resources and serious inefficiencies. Similarly, allocating common costs according to relative shares of costs directly allocated is a convenient bookkeeping device that bears no known relation to the Commission's objectives in general, nor to economic welfare more particularly. While both allocators may be recommended by their convenience and by their ease of calculation and administration, that advantage is more than offset by the cost of the inefficiencies they are sure to spawn.

While regulatory cost allocations are essentially arbitrary, they have not historically been without purpose. To the contrary, the cost allocation pattern developed historically by the Commission in countless proceedings involving jurisdictional separations, toll settlements, division of revenues, costing for determining interexchange carrier competitive rate responses, depreciation schedules that allocate costs over time, and others have in each case been driven in the first instance by clearly stated and widely understood Commission policies and intentions.

10. Please elaborate on your conclusion that administrative assignments of common costs are arbitrary. I cannot overemphasize the clarity and policy importance of that conclusion. Market forces allocate costs retrospectively. While cost accountants practice business line accounting, those allocations provide, at best, only general guidelines for pricing. Prices of different services are determined by the market and those market-determined prices result in absorption of common costs in varying shares by various product lines. These market-determined allocations are in sharp contrast to administered cost allocations, which may be used as the basis for influencing relative prices. Prices determined under the influence of administered cost allocations will almost certainly not be the same as if determined subject only to forces in the marketplace. Nor will they have the same economic -- static or dynamic -- efficiency properties.

Prospective cost allocation as contemplated in this proceeding leads in essence to pressures for a division of the market and determination of market share, not by the relative abilities of competing technologies, firms and services to satisfy user needs, but by the force of whatever arbitrary cost allocation convention the Commission chooses. In essence, allocation of costs by regulation revises the sequence of normal market processes. In competitive markets, competition determines prices, market shares and the allocations of common costs. The Commission is being urged to adopt an approach to cost allocation that will constrain the determination of relative prices, which in turn will influence expected market shares, earnings, and risks, thereby distorting demand-driven investment patterns.

The Commission's notice provides little or no support for relying on this "revised sequence" -- moving from cost allocations to prices, rather than from prices to cost allocations. Nor, does the Commission spell out the economic welfare implications or public policy rationale for usurping the central role of markets. In the context of the ubiquitous competitive forces likely to emerge in all markets as a result of the open entry, pro-competition provisions of the 1996 Act and of the existence of its price-cap scheme of earnings control, it is not at all clear what economic and market models the Commission is relying on to rationalize the need for interfering with competitive market processes.

11. You placed last on your list the goal of "guarding against subsidy of competitive services by monopoly network services". Isn't that an important objective? It is a very important objective, but I believe the Commission's current rules adequately ensure that carriers have little economic or financial incentive to practice systematic cross-subsidy from "monopoly network services". The theory of "predatory" cross-subsidy on which past Commission costing decisions has been based holds that regulated firms have an incentive to load costs onto regulated services and thereby to underprice unregulated services to the disadvantage of ratepayers in regulated markets and competitors in unregulated markets. The validity of the theory depends critically on the form of rate and earnings regulation.

Under rate of return regulation -- a cost plus scheme of earnings control -- costs initially allocated or shifted to regulated services can be recovered on a dollar for dollar basis from users of regulated services. However, under the present scheme of regulating prices through price-indexed caps, carriers are not assured to be able to recover all costs, including common costs. The key feature of price-cap regulation is complete separation between regulated prices and firms' production costs. Thus, under price caps there is no guarantee that revenues from regulated services will cover all costs. This implies that improperly shifted costs will have to be borne by shareholders. In short, the Commission's current price cap regulation is widely regarded by analysts, both within and outside the Commission, as assuring that regulated carriers have no financial incentive to shift costs from unregulated to regulated lines of business. Indeed, the prospect for eliminating the cross-subsidy incentive was a bedrock rationale for Commission adoption of price cap regulation in place of rate of return methods of earnings control.

Furthermore, it is no longer the case that the set of regulated services can automatically be regarded as amenable to monopoly pricing behavior. The gradual erosion of incumbents' market power in various local telephone markets will be accelerated as the open entry and interconnection provisions of the Act of 1996 are realized. Thus, both actual and potential competition will serve as a market constraint on incumbents' ability to practice uneconomic cost allocations.

12. *Could you elaborate, in context of the cost allocation issues, on the effects of the provisions in the new Law respecting open entry into local exchange markets?* The theory of cost shifting depends in the first instance on the existence of markets in which incumbents have market power and/or are regulated according to cost-plus forms of rate and earnings control. As indicated above, and recognized on numerous occasions in past Commission orders, price cap regulation eliminates the latter condition. Moreover, the new Act, and Commission proceedings initiated to implement it, are clearly designed to eliminate both the ability and incentive of local exchange carriers to shift costs to regulated services. The practical effect of the unbundling, interconnection, resale and other provisions of the Act will be to strip local exchange carriers of the degree of market power in the provision of regulated services necessary to support either the incentive, or the ability, to practice uneconomic cost shifting inimical to the public interest.

13. *What is the public's stake in the allocation of telco common costs between video and voice services?* Cost allocations between telco and cable services are two-edged swords and require balancing and trading-off between two conflicting goals. One goal is to prevent "cross-subsidization" of telco-provided cable services. However, as indicated above, protecting against cross-subsidy is not necessary in a price-cap regulatory environment, particularly in a market that is assured soon to be fully "contestable" as it is opened to full and fair competition in accordance with the new Act. Moreover, the public's interest in cost allocation and rates is not exhausted by consideration of potential for cross-subsidy. There are several negative effects on the public interest of cost allocations, if coupled with adminstrative reductions in telcos' rates for existing services. These negative effects include:

a. Reduction in the effectiveness of telco competition in disciplining cable system provision of video services. Specifically, as the share of telco common costs allocated to video services is increased, several negative effects may be expected:

- Upward pressure on telco provided video services and consequent higher cable rates;
- Competitive pressures on cable systems will be lessened, thereby leading to negative effects on i) the quality of cable service, ii) static operating efficiency of cable systems, iii) the diversity, extent and quality of cable programming, and, iv) the incentive generally of cable systems to be innovative and responsive to consumer needs.

b. Reduced incentives of telcos to invest and to take risks in the video services market and otherwise to provide competitive challenges to incumbent monopoly cable service providers. This will have the practical effect of slowing the rate of technological evolution of local telephone networks and the rate of development of advanced broadband networks, in direct contradiction to one of the main goals of the new Telecommunications Act.

c. Increased risk and reduced likelihood of competitive entry into the provision of local telephone services by CLECs and other access providers. The practical effect of loading common costs onto telco services competitive with cable will clearly be to dilute the market-based business case for telco video investment and will tend to encourage telcos to price other (regulated or unregulated) services at entry deterring levels. The irony is that loading common costs onto cable services thrusts the Commission into the position of encouraging the equivalent of what might otherwise be considered, if they were initiated by incumbents, "limit pricing" deterrents to new competitive entry into other services. Placing regulatory barriers to telco entry into the local video marketplace is difficult to justify on public policy or economic welfare grounds, and has not been rationalized, so far as I can tell, by the Commission.

14. *What will be the effect of the proposed allocation on the development of broadband networks by the telcos?* Video entertainment service that competes directly with cable system offerings is just one of many broadband services that may be provided by a modern digital, high capacity telephone network. Business demand for high speed data transfer and for videoconferencing, for example, may be addressed by such a network. Institutional demands for varying applications from telemedicine to distance learning to electronic library services may also be addressed. And, a common complaint of Internet and other electronic information transfer services users is the narrow bandwidth available in the local exchange network. Many of the new and innovative services identified in discussions of the "National Information Infrastructure" and the "Information Superhighway" are dependent on the development of high-speed, high capacity, local broadband networks.

Arbitrarily allocating unduly large proportions of common broadband network costs to telco provided, cable-system-competitive, video entertainment services,and administratively imposing corresponding reductions in rates for exisiting services, will slow down, limit, discourage and otherwise tend to deter telco investment in such networks. The result will be to deprive, or defer the availability to, users in other addressable markets of the benefits of ubiquitous broadband systems.

15. *How will the allocation impact carrier earnings from services regulated under price caps and what effect will that have on telcos' incentives to invest in facilities to support introduction of new information and video program services?* The impact on carrier earnings will depend, for the most part, on whether the Commission treats the allocated costs as "exogenous" and for that reason requires a commensurate downward adjustment in the LEC's price cap index. The practical effect of requiring such an adjustment and concomitant reduction in expected earnings from regulated services would be to discourage carriers from making any "dual purpose" investment that would

support both regulated and unregulated services. Requiring a downward price cap index adjustment, of any magnitude, to reflect cost allocations from fungible investment in telco plant is to impose a penalty on investment to modernize and expand network's current capacity to permit provision of new information and video services. In calculating the marginal impact on shareholder value of any incremental, fungible broadband investment, telco network planners and investment managers would be required to reduce the expected return from the investment by the amount of the reduced earnings on regulated services. This broadband investment "penalty", realized through reduced earnings on regulated services, would of course discourage such investment. On the margin, this penalty might very well be the determining factor in what is already likely to be an uncertain and risky undertaking. Thus, exogenous treatment of allocated common investment costs could very well chill investment in broadband systems and drive scarce capital into other pursuits.

Nor, should the Commission be tempted to balance this clear negative investment incentive with arguments that users of regulated services are "entitled" to benefits from economies of scope associated with investment supporting provision of regulated and unregulated services. The mechanics of price caps assure ratepayers will benefit from all economies, or productivity increases, including scope economies. The productivity offset in the price cap adjustment formula assures that users of regulated services gain from productivity increases in carrier economies of scale, scope, or other operating efficiencies. In view of the clear negative investment incentives sure to accompany exogenous treatment, there is no net gain in consumer welfare from singling out the efficiencies from telco broadband investment and to double count the associated productivity gains.

Finally, requiring change in the price cap index each time carriers offer a new unregulated service or expand the output of existing ones is to invite an administrative fiasco that directly contradicts both the Commission's desire to "keep it simple" and the Congressional mandate to scale back unneeded, burdensome regulation.

16. What steps might the Commission take to meet its statutory obligations to promote competition in video markets, to encourage investment in new technologies and to maximize consumer choice of services that best meet their information and entertainment needs? The Commission must recognize at the outset that investment by telcos sufficient to assure widespread deployment of systems capable of providing effective competition for cable system video services will require substantial outlays of investment capital and that such investment would be marked by enormous market uncertainty and financial risk. It is not at all clear that the market will support such investment, or in what measures, or in what time frames. What is clear is that the rules adopted in this proceeding will influence each of the financial components -- risk, return and growth -- by which sound management practices require such investments to be evaluated. Given the enormous market-based uncertainty and investment risk associated with broadband network deployment, and other attractive investment opportunities open to the LECs, even minor miscalculations by the Commission will have substantial and far-reaching impacts on the rate and level of carrier broadband investment. To assure that its rules meet statutory obligations, the Commission should solicit and analyze evidence of the kinds suggested by the following illustrative terms of inquiry:

- Given the extensive set of investment requirements and other opportunities available to telcos, and the conditions of demand and supply in the local video marketplace, what, and how compelling, are telco incentives to invest in ubiquitous local broadband capabilities?

- What prospective economic and financial (dis)incentives most influence telco decisions to invest and how are those impacted by the rules at issue in this proceeding? Specifically, what effect will each of the cost allocation alternatives set forth in the Notice have on the goal of encouraging new broadband investment and competition for incumbent cable monopolists?

- What effect will encouraging or discouraging telco broadband investment have on a) competition in local video markets, b) the incentive of cable system operators to modernize cable plant and to provide viewer options, c) the expanded universal service goals of the new Telecommunications Act and d) overall consumer economic welfare?

- What kinds of risks to the achievement of other policy goals should the Commission be willing to undertake on behalf of the public to assure adequate incentives for telcos to undertake widespread deployment of broadband networks?

17. *Does the Commission's Notice solicit such information?* Not specifically. Nor are the general terms of the Inquiry likely to call forth the information necessary for a reasonably complete evaluation of the effect of various costing alternatives on telco broadband investment incentives or on future competition and economic performance in local video distribution markets.

18. *But, what are the prospects for development of broadband, two way cable systems to address those markets?* The cable industry is of course pursuing that option with varying degrees of commitment and intensity. Some cable systems will probably develop such networks in the future. Many will not. There is no reasoned public policy basis, however, for handicapping new competitors to assure that cable operators can develop such systems free from the rigors of an openly competitive marketplace and

the discipline of rival technologies. There is every reason to commend the financial management skills of the cable industry. However, my assessment of the current financial strength of the cable industry, combined with my understanding of the financial and technical requirements of modernizing existing cable networks, suggests to me that the public will be served best by a policy that gives both cable systems and telcos the opportunity and incentive to build competing networks. Stripping either of the option will undoubtedly slow the pace of development of local broadband networks and defer the availability to users of advanced, broadband services of all stripes. The Commission should trust the marketplace and provide incentives, not protection, to cable systems and telcos alike.

19. *What effect, if any, will differential application of cost allocation restrictions to cable systems and telephone companies have on economic welfare and infrastructure development?* Cable systems electing regulation according to benchmark (price cap) regulation are generally exempt from cost allocation rules because of the Commission's explicit recognition that the benchmark system is concerned with prices, not costs. Thus, the offer of telephone services by a "benchmark-regulated" cable system would not be subject to regulatory cost allocations and artificial, nonmarket barriers to cost recovery. This circumstance, paired with a Commission determination to allocate common telephone network costs to video services as a means of assuring fair competition in the video market, would protect cable companies' video market shares and may create pressures leading to artificially and unnecessarily high rates for video services. Under current rules, there is no regulatory barrier to prevent cable companies from allocating large shares of common costs to video services and only modest shares to telephone services produced in common with video services over modernized cable networks. The result of this asymmetric regulation would be to encourage cable entry into telephony, while protecting cable systems video revenue streams from telco entry.

There is no clear public interest basis for this result and none is articulated in the Notice. The Commission can eliminate the regulatory asymmetries by bringing the telco regulatory costing regime into line with the one established previously for cable systems. Reciprocal entry into each others markets, a goal spelled out in the Act of 1996, can best be encouraged by eliminating artificial cost accounting and ratemaking barriers to competitive entrants and the introduction of new services in all markets.

Dissimilar treatment of cable entry into telephony and telco entry into video services cannot, so far as I can determine, be rationalized on welfare economics grounds. Both telcos and cable companies have market power in their primary lines of business -- voice telephony and video transmissions, respectively -- and the goal of competition policy should be to dissipate that power by encouraging new facilities based entry. To repeat, the Commission should trust in market place incentives, not protection from competition, to impel the investment programs of cable systems and telcos alike.

20. How will consumer welfare be affected by different allocations of telco costs between video and voice services? There is no single, nor simple answer. The impact will vary from consumer to consumer and between the short run and the long run.

Consumers pay common network costs in a variety of ways. Each telephone network service is priced to include some share of common network costs. Most households buy both cable television services and telephone services. For such households the allocation of common telephone network costs between regulated voice and unregulated video services is largely a matter of indifference. Reallocating costs between services leaves unchanged that household's total communications bill. Cost (re)allocations merely alter the composition of the bill among different services. Cost "shifting" between two services in the household consumption basket, leaves household real income and welfare practically unchanged Households using only one of the services will fare differently. Some will benefit from reallocating costs, but at the expense of others. But, ignoring distributional effects and avoiding the pitfalls of interpersonal utility comparisons, the net impact on economic welfare is zero.

Notwithstanding the benign short run consumer welfare effects, a given cost allocation program will have more substantial long run consequences through its impact on investment and infrastructure development. In an increasingly competitive local telecommunications environment, with open entry in both video and voice markets, cost allocations will influence the financial and investment profile of different network configurations and services. Cost allocations influence margins, expected earnings, risk and growth prospects in each business line and will through those have an impact on incentives to invest. Cost allocations are a means of influencing both the level and structure of infrastructure investment and, by those means, they will affect long run economic welfare.

21. What is the economic policy basis for differentiating between "ratepayers" -- as users of regulated voice services -- and users of nonregulated services? From an economic analysis point of view, classifying consumers as ratepayers and users of unregulated services is to create a distinction where there are frequently no differences. Most consumers use both regulated voice and unregulated video services. The basis for the distinction is disappearing, inasmuch as both classes of service are likely to be quite competitive in the future and, secondly, as noted above, price cap regulation has eliminated the distortive incentive effects of rate of return regulation and has thereby rendered moot traditional reasons for differentiating regulated and unregulated services. Thus, market changes and regulatory changes are eliminating the need for making such distinctions in policy proceedings

22. What is your view of the Commission's proposal to adopt a fixed allocator to assign *an arbitrary share of common costs to video services?* The Commission's tentative conclusion to establish allocation factors of fixed proportions to regulated and unregulated services on grounds of simplicity, auditability, and uniformity is not supported by the facts of cost accounting, inasmuch as even fixed allocators still leave substantial record keeping obligations to carriers and a host of questions about what accounts will be so divided, how and what kinds of records must be kept, and other costly administrative determinations . But, aside from the "false" simplicity and administrative ease of fixed allocators, their adoption does not, per se, address the broader and more important public policy implications of alternative cost allocations. The facts are that too large an allocation to unregulated services will discourage telco investment in broadband systems and reduce the incentives of incumbent cable companies to meet consumer needs and otherwise to respond to competitive market forces. A priori, there is no way to determine whether a particular fixed allocator is sending the "correct" market signals to either telco or cable system managers. The fixed allocator approach risks being distorted to protect incumbent video suppliers and denying consumers the benefits of additional video alternatives and greater competition in the marketplace.

23. *What specific, quantitative impact will different fixed common cost allocators -- say 20%, 50% and 70% -- between regulated and unregulated services have on the size, distribution and timing of telco investment in broadband systems and the effectiveness of future telecom competition to incumbent cable service providers?* I do not know. My best efforts are reflected in the qualitative statements above. I am not aware of any studies in which that is the principal question framed. But, more importantly, I do not believe the Commission will have sufficient facts and analysis at its command in this proceeding to be able to quantify reliably the effect of a given fixed allocator on the development of new broadband infrastructure and competition in video services provision. I expect also that the variance of the distribution of possible impacts is quite

high, thereby rendering quite risky to the achievement of Congressional goals, either guessing at the effect of fixed allocators on broadband investment or simply ignoring such effects.

24. What would be the effect of eliminating regulatory cost allocations entirely and permitting markets to do the job? Markets allocate common costs quite routinely in the unregulated sector and, apparently, without much notice or concern by consumers. The production of food, housing, medical care, transportation, fuel, entertainment and numerous other staples in the average household budget takes place without reference to regulatory cost allocations of the kind being considered here. Thus, administrative cost allocations are by no means necessary to the functioning of a market economy, even though firms routinely and extensively participate simultaneously in sub-markets with differential degrees of competition. Further there is no evidence from those sectors -- despite the wide range of diversification among firms and in degrees of competitiveness from one market to the next -- that regulatory cost allocations, the resulting potential distortion of relative prices and skewed investment incentives would do a better job of serving national economic goals Left to their own devices, markets will assure common cost recovery in a variety of ways, none of which can be fully anticipated and readily replicated by administrative processes. Market based cost allocations reflect fully the entire complex of technological and economic factors underlying market supply and demand curves. Firms' discretion over price and common cost allocation is limited by competition as reflected in demand elasticities and available substitutes. A firm's ability to manipulate prices and cost allocations is limited by available substitutes in the marketplace. Successful implementation of the new Act will assure that actual and potential competition will constrain carrier pricing options in all markets. Adoption of price cap regulation has already eliminated regulatory incentives for carriers to manipulate cost allocations and prices to the detriment of consumers of either regulated or unregulated services.

I declare under penalty of perjury that the foregoing is true and correct. Executed on June 11, 1996; Washington, D.C.

Larry F. Darby

Dr. Larry F. Darby

CERTIFICATE OF SERVICE

I, Bonnie H. Carpenter, hereby certify that on this 12th day of June, 1996, I caused the foregoing ***Reply Comments*** to be served by first-class mail, postage prepaid, to the parties listed on the attached service list.

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